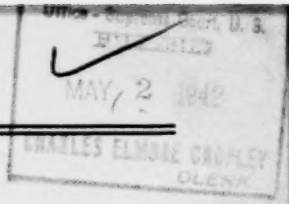

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

316 US # 15

No. 1207 JAN-LAN

JAMAICA WATER SUPPLY COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

HUGH SATTERLEE,
WM. R. GREEN, JR.,
Counsel for Petitioner

SUPREME PRINTING COMPANY, LAW PRINTERS, BARCLAY 7-0349

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

JAMAICA WATER SUPPLY COMPANY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, the Jamaica Water Supply Company, respectfully prays that a Writ of Certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered February 18, 1942, affirming the decision of the United States Board of Tax Appeals in the above case.

The Question Presented.

This is an income tax case. Stated in its simplest terms, the question is whether the petitioner should include in its gross income for its fiscal year ending June 30, 1934, $575,000 earned during the years 1923 to 1928, inclusive, but not collected until July, 1934.

Summary Statement.

The petitioner is a public utility furnishing water to the City of New York. (R. 32) Prior to July 1, 1913, its compensation was fixed by contract with the City at $18.00 per hydrant per annum. On that date the contract expired and thereafter the petitioner continued to supply water at the same rate until April 29, 1919, on which date it notified the City that from January 1, 1919, it would charge the City at the rate of $45.00 per hydrant. Beginning June 30, 1919, it regularly billed the City at the rate of $45.00 per hydrant. The City paid at the rate of $18.00 per hydrant and the petitioner accepted the payment under protest. (R. 32) Demands for full payment and intermittent negotiations as to rates continued until October 22, 1929, on which date petitioner brought suit to recover the balance due for the years 1919 to 1928, inclusive. (R. 33) On December 21, 1933, the City offered to allow judgment to be entered for the sum of $638,185.58, being the amount claimed by the petitioner ($527,355 plus interest of $110,830.58) for the years 1923 to 1928, inclusive, recovery for earlier years having been barred by the statute of limitations. Petitioner accepted the offer and judgment was entered on December 22, 1933. By a later agreement interest was reduced to $47,645. On July 25, 1934, the judgment was satisfied by the payment of $575,000, being $527,355 plus interest of $47,645. (R. 33)

During the period involved Section 472 of the Greater New York Charter required the petitioner, in the absence of a contract, to supply the City with water at rates which were just and reasonable and provided that "in case of a controversy the question of what is just and reasonable shall be determined as a judicial question on its merits by a court of competent jurisdiction."

The petitioner kept its books and filed its tax returns on the accrual basis and after 1931 kept its accounts on

the basis of a fiscal year ending on June 30th. (R. 33) After it began to charge the City at the higher rate, its hydrant rental records were kept in two columns, one recording the charge of $18.00 a year and the other the charge of $45.00 a year. Its journal entries were made on the basis of the $18.00 rate. (R. 32) In its tax returns for the years 1923 to 1928, inclusive, it included as income only the amount collected from the City. (R. 33-34) The cost of the service rendered was claimed as a deduction for the year in which the service was rendered. (R. 33)

The respondent determined that the $575,000 was income, not in the years in which it was earned, not in the year in which it was paid, but in the year in which the judgment was entered. The petitioner appealed to the Board of Tax Appeals, contending that the money was income for the years in which earned. The respondent in his answer (R. 21-25) pleaded estoppel. The petitioner in its reply (R. 25-27) alleged that, even if the amount paid by the City was included in its income for the years in which earned, a true and correct computation of its tax for such years would show little if any tax due. At the trial before the Board, the respondent withdrew the defense of estoppel. The Board sustained the respondent. (R. 44) The petitioner appealed to the Circuit Court of Appeals, contending that the money was income for the years in which earned or, in the alternative, in the year of payment. The Circuit Court sustained the Board of Tax Appeals.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on the 18th day of February, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. §347(a)).

Reasons for Granting the Writ.

1. The decision of the Circuit Court of Appeals is in conflict with the decisions of this Court and of other Circuit Courts of Appeals.

In the Federal Control Cases, *Continental Tie & Lumber Company* v. *United States*, 286 U. S. 290; *Commissioner* v. *Old Dominion S. S. Co.*, 47 Fed. (2d) 148; *Helvering* v. *St. Louis Southwestern Ry. Co.*, 66 Fed. (2d) 633; *New York Central Railroad Co.* v. *Commissioner*, 79 Fed. (2d) 247; *Commissioner* v. *Midland Valley R. Co.*, 57 Fed. (2d) 1042; *Helvering* v. *Gulf M. & N. R. Co.*, 71 Fed. (2d) 953, this Court and the lower courts have uniformly held that where the obligation to pay the reasonable value of services was fixed by law and "where nothing remains to be determined at the close of the year except the amount of just compensation on the basis of past facts and established principles" (*Commissioner* v. *Old Dominion S. S. Co., supra*), the amount ultimately received after the settlement or adjudication of a controversy as to the amount is income for the years in which it was earned. This class of cases has been aptly described as involving the "liquidation of a determined right." Where the cases involve "the determination of a disputed right" they uniformly hold that the amount ultimately received is income in the year of payment.

The court below erroneously concluded that this case involved "the determination of a disputed right," although the right to payment was fixed by law and the only dispute was as to the amount. Such holding apparently was on the theory, since the City had paid the amount which it conceded to be due and the controversy was over only the excess claimed by the petitioner, that the case involved the "determination of a disputed right" and that there was a "dispute as to any liability." The Court apparently did not note that in each of the Federal Con-

trol cases the transportation company had collected the uncontested amount of its compensation in the year in which the service was rendered. See in particular *Commissioner* v. *Midland Valley R. Co., supra,* and *Baltimore & O. R. Co.* v. *Commissioner,* 78 Fed. (2d) 456. The decision of the court below is thus clearly in conflict with the decisions of this Court and the lower courts.

2. The Circuit Court of Appeals has decided an important question of federal law which should be settled by this Court. The question of when income is accrued for purposes of inclusion in the gross income of taxpayers keeping their books and making their returns on the accrual basis is particularly pressing in this war period, when the national exigencies require the use of private facilities for Government purposes and the inclusion in war contracts of special and unusual provisions, which are likely to postpone the exact ascertainment of income to a time long subsequent to the year in which the income was earned and in which the facts existed which provide the basis for its final determination. A similar situation in the last war resulted in the Federal Control Cases, the principles of which evidently need clarification and application to the progress of the law in the last twenty years. Otherwise uncertainty and confusion will attend the interpretation for income tax purposes of current provisions for the war emergency. *Cf. John M. Enright Estate* v. *Helvering,* 312 U. S. 636.

3. The decision of the Circuit Court of Appeals is erroneous in that

(a) The money received was income for the years in which earned.

The facts of this case bring it squarely within the rule of the Federal Control Cases, *supra.*

(b) In the alternative, the money received was income in the year of collection.

The respondent has disregarded the applicable portion of Article 331 of Regulations 77 (Revenue Act of 1932), the material part of which reads as follows: "If a person sues in one year on a pecuniary claim or for property, and the money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received." Here the money was not "recovered" in the year for which the respondent proposes to include it in gross income.

(c) The imposition of the tax is unjust and inequitable.

The respondent withdrew his plea of estoppel after the petitioner pleaded that it had paid substantially all tax due even if the money was included in income for the year in which earned.

WHEREFORE, it is respectfully submitted that the petition should be granted.

HUGH SATTERLEE,
WM. R. GREEN, JR.,
Counsel for Petitioner

Dated, April 28, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

JAMAICA WATER SUPPLY COMPANY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Circuit Court of Appeals is reported in 125 Fed. (2d) 512. The opinion of the Board of Tax Appeals is reported in 42 B. T. A. 359. (R. 35-43)

Specification of Errors.

1. The decision of the Circuit Court of Appeals is erroneous in that

(a) The money received was income for the years in which earned.

(b) In the alternative, the money received was income in the year of payment.

(c) The imposition of the tax is unjust and inequitable.

Argument.

1. The decision of the Circuit Court of Appeals is in conflict with the decisions of this Court and the Circuit Court of Appeals.

The petitioner is on the accrual basis. It furnished water to the City of New York. Under the City's charter the City was required to pay just and reasonable compensation for the service rendered. The petitioner regularly billed the City at the rate of $45.00 per hydrant but the City paid only $18.00 per hydrant. Finally the petitioner brought suit and the matter was compromised by the City's agreement to permit judgment to be entered for the billed amount for the years as to which collection was not barred by the statute of limitations. The Board of Tax Appeals and the Court below held that the money collected was income, not when earned, not when collected, but in the year when judgment was entered.

The case is squarely within the rule of the Federal Control cases. *Continental Tie & Lumber Company* v. *United States*, 286 U. S. 290; *Commissioner* v. *Old Dominion S. S. Co.*, 47 Fed. (2d) 148; *Helvering* v. *St. Louis Southwestern Ry. Co.*, 66 Fed. (2d) 633; *New York Central Railroad Co.* v. *Commissioner*, 79 Fed. (2d) 247; *Commissioner* v. *Midland Valley R. Co.*, 57 Fed. (2d) 1042; *Helvering* v. *Gulf M. & N. R. Co.*, 71 Fed. (2d) 953. These cases hold that where the obligation to pay the reasonable value of services is fixed by law and "nothing remains to be determined at the close of the year except the amount of just compensation on the basis of past facts and established principles" the amount collected after the settlement or adjudication of a controversy as to the amount, is income for the years in which it was earned. In *Continental Tie & Lumber Co.* v. *United States, supra*, it was held that a payment made to the

taxpayer, also on the accrual basis, constituted income in 1920 when the right to additional payment was created by statute and not in a subsequent year when the award or the payment was made. The amount was held to be income for the year when the right to receive some payment was fixed and not in the year of award or payment.

The rule of the Federal Control Cases should no longer be confusing. In *Helvering* v. *St. Louis Southwestern Ry. Co.*, 66 Fed. (2d) 633, cert. denied 292 U. S. 626, Judge Stone segregated the then existing cases into two classes (1) those dealing with situations where there was "some dispute as to any liability or where the liability is contingent upon future happenings" and (2) "those where there is no contest over liability, and where the amount of the liability does not depend upon future events or contingencies". Judge L. Hand, in his dissenting opinion, in *Commissioner* v. *Brooklyn Union Gas Co.*, 62 Fed. (2d) 505, tersely classified the situations into (1) those dealing with "the determination of a disputed right" and (2) those dealing with "the liquidation of a determined right." No recent case, except the instant case, has been found which has not recognized the classifications pointed out by Judge Stone and Judge Hand and imposed tax accordingly. In *New York Central Railroad Co.* v. *Commissioner*, 79 Fed. (2d) 247, the Court said, "The compensation was earned when the services were performed, and no uncertainty existed except as to what was a fair and reasonable amount."

The Court below viewed this case as one where there was "some dispute as to any liability or where the liability is contingent on future happenings", *i. e.*, one involving "the determination of a disputed right." It overlooked the fact that in the Federal Control cases the uncontested part was paid as earned. *Commissioner* v. *Midland Valley R. Co.*, *supra*, and *Baltimore & O. R. Co.* v. *Commissioner*, 78 Fed. (2d) 456. There as here, the liability to pay was fixed by law and only the amount of

the liability remained to be determined. Partial payment does not make it a case involving "the determination of a disputed right." The petitioner asserts that this case should be classified with "those where there is no contest over liability, and where the liability does not depend upon future events." It involves "the liquidation of a determined right." "Nothing remains to be determined at the close of the year except the amount of just compensation on the basis of past facts and established principles" and accordingly the amount paid was income for the years in which earned.

2. The decision of the Circuit Court of Appeals is erroneous because

(a) The money was income for the years in which earned.

True for the reasons urged in (1) herein.

(b) The money was income in the year of receipt.

The petitioner contends, in the alternative, that the respondent should have followed Article 331 of Regulations 77 (Rev. Act 1932), the material part of which reads as follows:

> "If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received."

Here the money was not "recovered" in the year for which the respondent proposes to include it in gross income.

(c) The imposition of the tax is unjust and inequitable.

In the proceeding before the Board of Tax Appeals the respondent pleaded estoppel in his answer. The petitioner in its reply alleged that even if the amount paid

by the City had been added to its income for the years in which earned, a true and correct computation of tax for such years would show little if any tax due. At the trial before the Board, the respondent withdrew the defense of estoppel. Without more, and there is no more in the record, the petitioner may not say to this Court that it has already paid substantially all the tax due if the income here involved had been properly accrued as earned, but the inference to be drawn from the withdrawal of the plea of estoppel is obvious.

Conclusion.

We submit that the decision of the Circuit Court of Appeals is in conflict with the decisions of this Court and the lower courts; is contrary to the income tax regulations; and is unjust, erroneous and inequitable, and that if such decision is not reversed confusion will result. We respectfully submit that the petition for certiorari should be granted.

HUGH SATTERLEE,
WM. R. GREEN, JR.,
Counsel for Petitioner

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1207

JAMAICA WATER SUPPLY COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 30–43) is reported in 42 B. T. A. 359. The opinion of the Circuit Court of Appeals (R. 142–145) is reported in 125 F. (2d) 512.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 18, 1942 (R. 146). The petition for a writ of certiorari was filed on May 2, 1942. Jurisdiction of this Court is invoked

under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner water company supplied a municipality with hydrant service, claiming as reasonable compensation a rate in excess of that contended for and paid by the city. Suit by petitioner to recover the difference terminated in a consent judgment during a later year. The judgment was paid in a still later tax year. The question is whether petitioner, at all times on the accrual basis, should account for the amount of the judgment as income in the years during which it was earned, in the year when the judgment was entered, or in the year when the judgment was paid.

STATUTE AND REGULATIONS INVOLVED

The relevant statutory provisions and regulations are set forth in the Appendix, infra, pp. 11–15.

STATEMENT

The facts may be summarized as follows from the findings of the Board of Tax Appeals (R. 32–35) and the stipulation of the parties before the Board (R. 53–138):

Petitioner water company is a New York corporation engaged in supplying water for domestic and public purposes, including the furnishing of fire protection, in Queens County, New York (R. 32). Until July 1, 1913, petitioner supplied hy-

drant service to the City of New York in the Borough of Queens under a contract which provided for a rental of $18 per hydrant per annum. The contract terminated on July 1, 1913. Thereafter petitioner continued to supply service at the same rate. On April 29, 1919, petitioner advised the City that from January 1, 1919, it would charge a rental of $45 per hydrant per annum. Beginning June 30, 1919, petitioner regularly billed the City at the $45 rate. The City, however, continued to pay only $18. The water company accepted these payments under protest, later filing claims with the City for the difference. (R. 32.)

On October 22, 1929, petitioner brought an action against the City to recover, with interest, $822,330.42, which was calculated to be the difference between the amount paid by the City to petitioner at the $18 rate and the amount for which petitioner had billed the City at the $45 rate for service rendered during the years 1919 to 1928, inclusive (Ex. Y, R. 120–123). The City contested the action on the grounds that the $45 rate was not fair and reasonable, that petitioner had received the payments made at the $18 rate in full accord and satisfaction of its claims, and that these claims were in part barred by the statute of limitations (Ex. Z, R. 124–126).

On December 21, 1933, the City made an offer to allow judgment to be taken against it in the sum of

$638,185.58, representing principal of $527,355[1] and interest of $110,830.58. The offer was accepted, and a consent judgment was entered on December 22, 1933. By an agreement made shortly thereafter the interest was reduced to $47,645. On July 25, 1934, payment was made in satisfaction of the judgment in the sum of $575,000, being $527,355 principal plus interest of $47,645. (R. 33.)

The hydrant rental account was shown on petitioner's books in two columns, one recording the charge of $18 per hydrant and the other a charge of $45. Its journal entries were made on the basis of the $18 rate. (R. 32.) Before and after 1933 petitioner consistently maintained its books on the accrual basis, and prepared and filed its federal income-tax returns accordingly. In its income-tax returns for the tax years[2] 1923 to 1928, inclusive, petitioner included income at the $18 rate per hydrant and not at the $45 rate. (R. 33–34.) The entire cost of furnishing hydrant service for each of the years 1923 to 1928, inclusive, was charged by petitioner on its books to the years in which that service was rendered. The cost was claimed as a deduction on petitioner's income-tax returns filed for those years and was allowed. (R. 33.)

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[1] This amount was based on payment at the increased rate during the years 1923 to 1928, inclusive, in respect of which petitioner's claims were not barred by the statute of limitations.

[2] Petitioner kept its accounts on the basis of a fiscal year ending June 30 (Pet. 2–3).

The Commissioner included in petitioner's gross income for the fiscal year ended June 30, 1934, the $575,000 received from the City in satisfaction of the judgment (R. 34). The Board of Tax Appeals sustained the action of the Commissioner (R. 30). The Circuit Court of Appeals affirmed (R. 146).

ARGUMENT

1. During the tax years involved in the present case section 472 of the Greater New York Charter required petitioner to supply hydrant service in Queens under the superintendence of a city commissioner at rates which were just and reasonable; in case of controversy over what rate was just and reasonable the issue was to be determined judicially. See R. 144; Pet. 2. Petitioner between 1913 and 1919 furnished service to the City at $18 per hydrant per annum, in accordance with the rate set in the earlier expired contract. Subsequently, the City paid for continued service at the $18 rate, contending that it was liable for no additional charge. Until the close of petitioner's suit against the city, it was not determined that the City was under *any* liability to petitioner. Accordingly, the sum received in payment of the consent judgment did not accrue as income during the years 1923–1928, but in December 1933, when both the existence and amount of the City's liability were ascertained. *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Lucas* v. *North*

Texas Co., 281 U. S. 11; *Patrick McGuirl, Inc.*, v. *Commissioner*, 74 F. (2d) 729 (C. C. A. 2), certiorari denied, 295 U. S. 748; cf. *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115; *Lucas* v. *American Code Co.*, 280 U. S. 445.

2. Petitioner asserts that the decision of the court below conflicts with the decisions of this Court and of other circuit courts of appeals in *Continental Tie & Lumber Co.* v. *United States*, 286 U. S. 290; *New York Central R. R.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2), certiorari denied, 296 U. S. 653; *Helvering* v. *Gulf, M. & N. R. R.*, 71 F. (2d) 953 (App. D. C.); *Helvering* v. *St. Louis Southwestern Ry.*, 66 F. (2d) 633 (C. C. A. 8), certiorari denied, 292 U. S. 626; *Commissioner* v. *Midland Valley R. R.* 57 F. (2d) 1042 (C. C. A. 10); and *Commissioner* v. *Old Dominion S. S. Co.*, 47 F. (2d) 148 (C. C. A. 2).

The *Continental Tie & Lumber Co.* case concerned a short-line railroad which competed with railroads under federal control prior to March 1, 1920. Section 204 of the Transportation Act, 1920, provided for award and payment to such a railroad to compensate for deficits in operating income incurred during the part of the period of federal control when the private company operated its own road. The Court held that income arising from an award made by the Interstate Commerce Commission and paid by the Treasury in 1923 accrued, nevertheless, in 1920, because the right to receive the income became established on

enactment of the Transportation Act; only administrative computation of the amount remained to be done, and that amount was already approximately ascertainable from data in the company's books.

In the *New York Central* case the railroad received in 1920 and 1921 additional compensation for mail carriage in 1916 and 1917; the court merely held that these sums were not income in 1920, but had accrued at least as early as 1919, when the Interstate Commerce Commission had rendered a decision settling the basis for additional railway mail pay.[3]

The other cases cited by petitioner as conflicting concerned railroads entitled to receive just compensation from the United States for use of their lines during federal control; in each an amount above the "standard return" (contemplated by the Federal Control Act to be applicable in the majority of cases) was paid to the taxpayer railroad after the period of federal control. In these cases liability for compensation was apparent as early as the years to which earning of the compensation was attributable; only the amount of the compensation remained to be determined. The courts held that the sums determined to be due and paid in years after 1920 accrued as income during

[3] An entirely similar issue in the *Gulf* case was disposed of in the same way by the Court of Appeals on a limited reconsideration. 71 F. (2d) at 956.

the years in which they were earned. These decisions are entirely consonant in result with the decisions of this Court referred to at pages 5 and 6, *supra*.

Petitioner states, however, that in each case the taxpayer had received the "uncontested amount of its compensation in the year in which the service was rendered" (Pet. 4–5, 9),[4] implying that the Government then disputed the taxpayer's right to receive any further compensation; a conflict is therefore said to exist with the decision below. However, it will be noted that, under section 2 of the Federal Control Act, until a carrier made an agreement with the Government on compensation the President was authorized to pay it not exceeding 90 percent of the "standard return", pending a determination of the total just compensation. Section 2 of the Act of March 21, 1918, c. 25, 40 Stat. 451. In each of the federal control cases cited by petitioner agreement was not reached until final settlement, and the intermediate dispute, then, concerned the *amount* of additional compensation due, the Government acknowledging some further liability. See 71 F. (2d) at 954; 66 F.

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[4] In the *Old Dominion* case none of the compensation was paid during the years when it was earned. See 47 F. (2d) at 149. The opinions in the *Gulf* and *St. Louis Southwestern* cases do not disclose that any amounts were paid by the Government to the railroads before 1920. See 71 F. (2d) at 954; 66 F. (2d) at 633.

(2d) at 633; 57 F. (2d) at 1043; 47 F. (2d) at 149. Accordingly, these circuit court of appeals cases present no conflict with the decision below, where the City of New York denied that it was under any liability to petitioner after it paid current bills at the $18 rate between 1919 and 1928.

3. Petitioner's alternative argument, that the amount of the consent judgment was income for its tax year 1935 rather than for its tax year 1934, is without merit since petitioner kept its books on the accrual basis. All of the factors definitely fixing liability of the City to pay were determined in December 1933, within the fiscal year ending June 30, 1934; the right to receive was established by the consent judgment and the amount receivable was then accrued. The time of actual receipt is therefore immaterial. *Spring City Foundry Co.* v. *Commissioner,* 292 U. S. 182. Petitioner's reliance (Pet. 10) on Article 331 of Regulations 77 for a different result is mistaken. The article does not differentiate between the year in which judgment is given and the year in which the judgment is paid, but merely states that money recovered in litigation does not result in the accrual of income for an earlier year during which the claim in suit arose.

CONCLUSION

The decision of the Circuit Court of Appeals is correct. It follows the applicable principles an-

nounced by this Court and presents no conflicts. It is therefore respectfully submitted that the petition should be denied.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
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Special Assistants to the Attorney General.
LEONARD C. MEEKER,
Attorney.

MAY 1942.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

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Part IV—Accounting Periods and Methods of Accounting

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in

the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

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SEC. 48. DEFINITIONS.

When used in this title—

(a) *Taxable Year.*—"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1932, shall be the calendar year 1932 or any fiscal year ending during the calendar year 1932.

(b) *Fiscal Year.*—"Fiscal year" means an accounting period of twelve months ending

on the last day of any month other than December.

(c) *Paid, Incurred, Accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

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ART. 324. *Accounting period.*—The return of a taxpayer is made and his income com-

puted for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 321–323.) Where no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the taxable year of its determination, if the return is rendered on the accrual basis; or, for the taxable year in which received, if the return is rendered on the receipts and disbursements basis. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (See article 191.) Such items as claims for compensation under canceled Government contracts constitute income for the year in

which they are allowed or their value is otherwise definitely determined.

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ART. 341. *"Paid or incurred"* and *"paid or accrued."*—The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in Title I must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Act, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

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